

Mason County Eastern School District

REPORT ON FINANCIAL STATEMENTS
(with required supplementary information)

Year ended June 30, 2006

Mason County Eastern School District

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Mason County Eastern Schools

Management's Discussion and Analysis

This section of Mason County Eastern Public Schools' annual financial report presents our discussion and analysis of the School District's financial performance during the year ended June 30, 2006. Please read it in conjunction with the School District's financial statements, which immediately follow this section.

Using this Annual Report

This annual report consists of a series of financial statements and notes to those statements. These statements are organized so the reader can understand Mason County Eastern Public Schools financially as a whole. The District-wide Financial Statements provide information about the activities of the whole School District, presenting both an aggregate view of the School District's finances and a longer-term view of those finances. The fund financial statements provide the next level of detail. For governmental activities, these statements tell how services were financed in the short-term, as well as what remains for future spending. The fund financial statements look at the School District's operations in more detail than the district-wide financial statements by providing information about the School District's most significant fund, the General Fund, with all other funds presented in one column as nonmajor funds. The remaining statement, the Statement of Fiduciary Net Assets, presents financial information about activities for which the School District acts solely as an agent for the benefit of students and parents.

Overview of the Financial Statements

This annual report consists of five parts: (1) management's discussion and analysis (this section), (2) the auditor's opinion, (3) the basic financial statements, (4) the required supplementary information and (5) other documents. The financial statements include notes that explain some of the information in the statements by providing detailed data. These statements are followed by a section of required supplementary information that further explains and supports the financial statements, utilizing a comparison to the District's budget for the year. Additionally, the basic financial statements also include two kinds of statements that present different views of the District.

Reporting the School District as a Whole – District-Wide Financial Statements

One of the most important questions asked about the School District is, "As a whole, what is the School district's financial condition as a result of the year's activities?" The Statement of Net Assets and the Statement of Activities, which appear first in the School District's financial statements, report information about the School District as a whole and its activities in a way that helps you answer this question. We prepare these statements to include all assets and liabilities, using the accrual basis of accounting, which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the School District's net assets – the difference between assets and liabilities, as reported in the Statement of Net Assets – as one way to measure the School District's financial health or financial position. Over time, increases or decreases in the School District's net assets – as reported in the Statement of Activities – are indicators of whether its financial health is improving or deteriorating. The relationship between revenues and expenses is the School District's operating results. However, the School District's goal is to provide services to our students, not to generate profits as commercial entities do. One must consider many other non-financial factors, such as the quality of the education provided and the safety of the schools, to assess the overall health of the School District.

The Statement of Net Assets and Statement of Activities report the governmental activities for the School District, which encompass all of the School District's services, including instruction, support services, community services, athletics, and food services. Property taxes, unrestricted State Aid (foundation allowance revenue), and State and federal grants finance most of these activities.

Reporting the School District's Most Significant Funds – Fund Financial Statements

The School District's fund financial statements provide detailed information about the most significant funds – not the School district as a whole. Some funds are required to be established by State law and by bond covenants. However, the School District establishes many other funds to help it control and manage money for particular purposes (the Food Services and Athletics Funds are examples) or to show that it's meeting legal responsibilities for using certain taxes, grants, and other money (such as bond-funded construction funds used for voter-approved capital projects).

Governmental Funds

All of the School District's services are reported in governmental funds. Governmental fund reporting focuses on showing how money flows into and out of funds and the balances left at year end that are available for spending. They are reported using an accounting method called modified accrual accounting, which measures cash and all other financial assets that can readily be converted to cash. The governmental fund statements provide a detailed short-term view of the operations of the School District and the services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the School District's programs. We describe the relationship (or differences) between governmental activities (reported in the Statement of Net Assets and the Statement of Activities) and governmental funds in a reconciliation.

The School District as Trustee – Reporting the School District's Fiduciary Responsibilities

The School District is the trustee, or fiduciary, for its student activity funds. All of the School District's fiduciary activities are reported in a separate Statement of Fiduciary Assets and Liabilities. We exclude these activities from the School District's other financial statements because the School District cannot use these assets to finance its operations. The School District is responsible for ensuring that the assets reported in these funds are used for their intended purposes.

The School District as a Whole

Recall that the Statement of Net Assets provides the perspective of the School District as a whole. Table 1 provides a summary of the School District's net assets as of June 30, 2005 and 2006.

TABLE 1	Governmental Activities <u>June 30, 2005</u>	Governmental Activities <u>June 30, 2006</u>
Assets		
Current assets	\$ 2,476,509	\$ 2,226,798
Capital assets	<u>5,014,172</u>	<u>4,908,061</u>
Total Assets	<u>7,490,681</u>	<u>7,134,859</u>
Liabilities		
Current liabilities	1,769,890	1,615,096
Long-term liabilities	<u>4,402,596</u>	<u>4,236,239</u>
Total liabilities	<u>6,172,486</u>	<u>5,851,335</u>
Net Assets		
Invested in capital assets –		
Net of related debt	445,079	471,950
Restricted	183,895	190,183
Unrestricted	<u>689,221</u>	<u>621,391</u>
Total net assets	<u>\$ 1,318,195</u>	<u>\$ 1,283,524</u>

The School District's net assets were \$1,283,524 as of June 30, 2006 (see Table 1). Capital assets, net of related debt, totaling \$471,950 compares the original cost (less depreciation) of the School District's capital assets to long-term debt used to finance the acquisition of those assets. Most of the debt will be repaid from voter-approved property taxes collected as the debt service comes due. Restricted net assets (\$190,183) are reported separately to show legal constraints from debt covenants and enabling legislation that limit the School District's ability to use those net assets for day-to-day operations. The remaining amount of net assets (\$621,391) is unrestricted.

The \$621,391 of unrestricted net assets of governmental activities represents the accumulated results of all past years' operations. The unrestricted net asset balance is used to provide working capital and cash flow requirements as well as providing for future uncertainties. The operating results of the General Fund will have significant impact on the change in unrestricted net assets from year to year.

The results of this year's operations for the School District as a whole are reported in the Statement of Activities (see Table 2), which shows the changes in net assets for fiscal years 2005 and 2006.

TABLE 2

	Governmental Activities <u>June 30, 2005</u>	Governmental Activities <u>June 30, 2006</u>
Revenue		
Program revenue:		
Charges for services	\$ 108,723	\$ 86,229
Operating grants/contributions	1,123,005	684,799
General revenue:		
Property taxes	1,185,224	1,294,004
Unrestricted grants/contributions	3,366,790	3,322,398
Other	<u>60,853</u>	<u>98,788</u>
Total revenue	<u>5,844,595</u>	<u>5,486,218</u>
Function/Program Expenses		
Instruction	3,364,646	3,028,378
Support services	1,634,105	1,741,813
Food services	240,756	241,173
Athletics	127,214	115,241
Interest on long-term debt	219,687	210,329
Unallocated depreciation	<u>183,419</u>	<u>183,955</u>
Total expenses	<u>5,769,827</u>	<u>5,520,889</u>
Increase (Decrease) in Net Assets	<u>\$ 74,768</u>	<u>\$ (34,671)</u>

As reported in the statement of activities, the cost of all of our governmental activities this year was \$5,520,889. Certain activities were partially funded from those who benefited from the programs (\$86,229) or by other governments and organizations that subsidized certain programs with grants and contributions (\$684,799). We paid for the remaining "public benefit" portion of our governmental activities with \$1,294,004 in taxes, \$3,322,398 in State Foundation Grant, and with our other revenues, such as interest and general entitlements. Operating grants/contributions revenue was down and Instruction expense was down. Both changed significantly (\$390,000) due to no Freedom To Learn program in 2005-2006.

The School District experienced a decrease in net assets of \$34,671. With the uncertainty of state funding and county-wide enrollment trends, a decrease of only 0.6% in net assets is very positive.

As discussed above, the net cost shows the financial burden that was placed on the State and the School District's taxpayers by each of these functions. Since property taxes for operations and unrestricted State Aid constitute the vast majority of district operating revenue sources, the Board of Education and Administration must annually evaluate the needs of the School District and balance those needs with State-prescribed available unrestricted resources.

As we noted earlier, the School District uses funds to help it control and manage money for particular purposes. Looking at funds helps the reader consider whether the School District is being accountable for the resources taxpayers and others provide to it and may provide more insight into the School District's overall financial health.

As the School District completed this year, the governmental funds reported a combined fund balance of \$881,623, which is a decrease of \$60,225 from last year. The main reason for the decrease is the General Fund fund balance decreased \$50,097 due to decreased foundation allowance revenue as a result of lower student enrollment.

The General Fund fund balance is available to fund costs related to allowable school operating purposes.

The Debt Service Fund showed a fund balance of \$190,183. Millage rates are determined annually to ensure that the School District accumulates sufficient resources to pay annual bond issue-related debt service. Debt Service Fund fund balances are reserved since they can only be used to pay debt service obligations.

General Fund Budgetary Highlights

Over the course of the year, the School District revises its budget as it attempts to deal with unexpected changes in revenues and expenditures. State law requires that the budget be amended to ensure that expenditures do not exceed appropriations. The final amendment to the budget was actually adopted just before year end. (A schedule showing the School District's original and final budget amounts compared with amounts actually paid and received is provided in the required supplemental information of these financial statements).

The variance of approximately \$52,000 in Basic Programs was due largely to encumbered expenses which were not purchased and insurance expense which was less than budgeted due to employee premium contributions.

Capital Assets

At June 30, 2006, the School District had \$4,878,538 (after accumulated depreciation) invested in a broad range of capital assets, including land, buildings, vehicles, and furniture and equipment. This amount represents a net decrease (including additions, deductions, and depreciation) of \$103,691, or 2.1 percent, from last year.

	<u>2006</u>	<u>2005</u>
Land	\$ 86,079	\$ 86,079
Building and building improvements	5,878,075	5,877,875
Buses and other vehicles, furniture and equipment	<u>786,197</u>	<u>706,133</u>
Total capital assets, before depreciation	<u>\$ 6,750,351</u>	<u>\$ 6,670,087</u>

Debt

At the end of this year, the School District had \$4,304,523 in bonds outstanding versus \$4,496,943 in the previous year – a decrease of 4.3 percent.

Other obligations include compensated absences. We present more detailed information about our long-term liabilities in the notes to the financial statements.

Economic Factors and Next Year's Budget

Our school board and administration considered many factors when setting the School District's 2007 fiscal year budget. One of the most important factors affecting the budget is our student count. The State foundation allowance is determined by multiplying the foundation allowance per pupil by the average blended count from the last three years. The 2007 budget was adopted in June 2006, based on an estimate of all students that will be enrolled in September 2006.

Approximately 84 percent of total General Fund revenue is from the foundation allowance.

Under State law, the School District cannot assess additional property tax revenue for general operations. As a result, School District funding is heavily dependent on the State's ability to fund local school operations. We anticipate that the fall student count will be close to the estimates used in creating the 2007 budget. Once the final student count and related per pupil funding is validated, State law requires the School District to amend the budget if actual School District resources are not sufficient to fund original appropriations.

The recently adopted state School Aid Budget estimates funds are sufficient to fund \$7,085 per pupil.

A teacher contract was ratified June 6, 2006. The cost of the settlement is reflected in the 2007 budget.

Contacting the School District's Financial Management

This financial report is designed to provide the School District's citizens, taxpayers, customers, investors, and creditors with a general overview of the School District's finances and to demonstrate the School District's accountability for the money it receives. If you have questions about this report or need additional financial information, contact our Business Department at 18 South Main, MCE Administration Office, Custer, Michigan 49405

BRICKLEY DELONG

CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

August 30, 2006

Board of Education
Mason County Eastern School District
Custer, Michigan

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Mason County Eastern School District (the School District), as of and for the year ended June 30, 2006, which collectively comprise the Schools District's basic financial statements as listed in the table of contents. These financial statements are the responsibility of Mason County Eastern School District's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of Mason County Eastern School District as of June 30, 2006 and the respective changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards* we have also issued our report dated August 30, 2006, on our consideration of Mason County Eastern School District's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

BRICKLEY DELONG

Board of Education
August 30, 2006
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The management's discussion and analysis and budgetary comparison information on pages i - vii and page 25, are not a required part of the basic financial statement but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Brickley DeLong, PLC

Mason County Eastern School District
STATEMENT OF NET ASSETS
June 30, 2006

ASSETS

	Governmental activities
CURRENT ASSETS	
Cash and cash equivalents	\$ 328,012
Investments	1,166,758
Receivables	33,748
Due from other governmental units	667,135
Inventories	9,776
Prepaid items	21,369
Total current assets	<u>2,226,798</u>
NONCURRENT ASSETS	
Capital assets, net	
Nondepreciable	86,079
Depreciable	4,792,459
Note receivable	29,523
Total noncurrent assets	<u>4,908,061</u>
Total assets	<u>7,134,859</u>
LIABILITIES AND NET ASSETS	
CURRENT LIABILITIES	
State aid loan	950,000
Accounts payable and accrued liabilities	409,279
Deferred revenue	21,380
Bonds and other obligations, due within one year	234,437
Total current liabilities	<u>1,615,096</u>
NONCURRENT LIABILITIES	
Bonds and other obligations, less amounts due within one year	4,236,239
Total liabilities	<u>5,851,335</u>
NET ASSETS	
Invested in capital assets, net of related debt	471,950
Restricted for debt service	190,183
Unrestricted	621,391
Total net assets	<u>\$ 1,283,524</u>

The accompanying notes are an integral part of this statement.

Mason County Eastern School District
STATEMENT OF ACTIVITIES
For the year ended June 30, 2006

<i>Functions/Programs</i>	Expenses	Program Revenue		Net (Expense)
		Charges for services	Operating grants and contributions	Revenue and Changes in Net Assets
Governmental activities				Governmental activities
Instruction	\$ 3,028,378	\$ 2,971	\$ 517,954	\$ (2,507,453)
Support services	1,741,813	-	9,955	(1,731,858)
Food services	241,173	68,468	156,890	(15,815)
Athletics	115,241	14,790	-	(100,451)
Interest on long-term debt	210,329	-	-	(210,329)
Unallocated depreciation	183,955	-	-	(183,955)
Total governmental activities	<u>\$ 5,520,889</u>	<u>\$ 86,229</u>	<u>\$ 684,799</u>	(4,749,861)
General revenues				
Property taxes levied for				
General purposes				908,445
Debt service				385,559
Grants and contributions not restricted to specific programs				3,322,398
Investment earnings				47,282
Miscellaneous				51,506
Total general revenues				<u>4,715,190</u>
Change in net assets				(34,671)
Net assets at July 1, 2005				<u>1,318,195</u>
Net assets at June 30, 2006				<u>\$ 1,283,524</u>

The accompanying notes are an integral part of this statement.

Mason County Eastern School District
BALANCE SHEET
Governmental Funds
June 30, 2006

	General Fund	Other governmental funds	Total governmental funds
ASSETS			
Cash and cash equivalents	\$ 266,552	\$ 61,460	\$ 328,012
Investments	1,026,758	140,000	1,166,758
Receivables	31,340	2,408	33,748
Due from other governmental units	665,127	2,008	667,135
Due from other funds	1,572	-	1,572
Inventories	-	9,776	9,776
Prepaid items	19,797	1,572	21,369
Total assets	<u>\$ 2,011,146</u>	<u>\$ 217,224</u>	<u>\$ 2,228,370</u>
LIABILITIES AND FUND BALANCES			
Liabilities			
State aid loan	\$ 950,000	\$ -	\$ 950,000
Accounts payable	10,921	5,163	16,084
Accrued liabilities	354,088	3,623	357,711
Due to other funds	-	1,572	1,572
Deferred revenue	20,206	1,174	21,380
Total liabilities	<u>1,335,215</u>	<u>11,532</u>	<u>1,346,747</u>
Fund balances			
Reserved			
Inventories and prepaid items	19,797	11,348	31,145
Debt service	-	190,183	190,183
Unreserved			
Undesignated			
General Fund	656,134	-	656,134
School service	-	4,161	4,161
Total fund balances	<u>675,931</u>	<u>205,692</u>	<u>881,623</u>
Total liabilities and fund balances	<u>\$ 2,011,146</u>	<u>\$ 217,224</u>	<u>\$ 2,228,370</u>

The accompanying notes are an integral part of this statement.

Mason County Eastern School District
**RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET
 TO THE STATEMENT OF NET ASSETS**
 June 30, 2006

Total fund balance—governmental funds		\$ 881,623
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Amounts reported for governmental activities in the Statement of Net Assets
 are different because:

Capital assets used in governmental activities are not current financial resources and
 are not reported in the governmental funds.

Cost of capital assets	\$ 6,750,351	
Accumulated depreciation	<u>(1,871,813)</u>	4,878,538

Other long-term note receivable in governmental activities is not reported in the governmental funds.	29,523
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Accrued interest in governmental activities is not reported in the governmental funds.	(35,484)
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Long-term liabilities in governmental activities are not due and payable in the
 current period and are not reported in the governmental funds.

Bonds and notes payable	(4,406,588)	
Compensated absences	<u>(64,088)</u>	<u>(4,470,676)</u>

Net assets of governmental activities in the Statement of Net Assets	\$ <u><u>1,283,524</u></u>
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The accompanying notes are an integral part of this statement.

Mason County Eastern School District
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
Governmental Funds
For the year ended June 30, 2006

	General Fund	Other governmental funds	Total governmental funds
REVENUES			
Local sources			
Property taxes	\$ 908,445	\$ 385,559	\$ 1,294,004
Investment earnings	40,488	6,794	47,282
Fees and charges	-	83,258	83,258
Other	30,953	-	30,953
Total local sources	979,886	475,611	1,455,497
State sources	3,576,345	10,086	3,586,431
Federal sources	269,779	146,804	416,583
Total revenues	4,826,010	632,501	5,458,511
EXPENDITURES			
Instruction	3,033,678	-	3,033,678
Support services	1,818,278	-	1,818,278
Food services	-	241,173	241,173
Athletics	-	115,241	115,241
Debt service			
Principal	-	180,000	180,000
Interest and other charges	-	206,064	206,064
Total expenditures	4,851,956	742,478	5,594,434
Excess (deficiency) of revenues over (under) expenditures	(25,946)	(109,977)	(135,923)
OTHER FINANCING SOURCES (USES)			
Transfers from other governmental units and other transactions	18,418	-	18,418
Loan proceeds	69,700	-	69,700
Transfers in	-	99,849	99,849
Transfers out	(99,849)	-	(99,849)
Transfers to other governmental units and other transactions	(12,420)	-	(12,420)
Total other financing sources (uses)	(24,151)	99,849	75,698
Net change in fund balances	(50,097)	(10,128)	(60,225)
Fund balances at July 1, 2005	726,028	215,820	941,848
Fund balances at June 30, 2006	\$ 675,931	\$ 205,692	\$ 881,623

The accompanying notes are an integral part of this statement.

Mason County Eastern School District
**RECONCILIATION OF THE GOVERNMENTAL FUNDS STATEMENT OF REVENUES, EXPENDITURES
 AND CHANGES IN FUND BALANCES TO THE STATEMENT OF ACTIVITIES**

For the year ended June 30, 2006

Net change in fund balances—total governmental funds	\$	(60,225)
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Amounts reported for governmental activities in the Statement of Activities are different because:

Governmental funds report outlays for capital assets as expenditures; in the Statement of Activities these costs are depreciated over their estimated useful lives.

Depreciation expense	\$ (183,955)	
Capital outlay	<u>80,264</u>	(103,691)

Payments received on notes receivable are reported as revenues in the governmental funds; the payments are netted against notes receivable on the Statement of Net Assets		(2,420)
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Debt proceeds are other financing sources in the governmental funds; but the proceeds increase long-term obligations in the Statement of Net Assets.		(69,700)
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Repayment of principal on long-term obligations is an expenditure in the governmental funds, but the repayment reduces long-term obligations in the Statement of Net Assets.		200,262
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Interest expense on long-term obligations is recorded in the Statement of Activities when incurred, but is not reported in governmental funds until paid.		(517)
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Compensated absences are reported on the accrual method in the Statement of Activities and reported as expenditures when financial resources are used in the governmental funds.		<u>1,620</u>
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Change in net assets of governmental activities	\$	<u><u>(34,671)</u></u>
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The accompanying notes are an integral part of this statement.

Mason County Eastern School District
STATEMENT OF FIDUCIARY ASSETS AND LIABILITIES
Fiduciary Funds
June 30, 2006

	<u>Agency funds</u>
ASSETS	
Cash and cash equivalents	\$ <u>34,265</u>
 LIABILITIES	
Deposits held for others	\$ <u>34,265</u>

The accompanying notes are an integral part of this statement.

Mason County Eastern School District
NOTES TO FINANCIAL STATEMENTS

June 30, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of Mason County Eastern School District (School District) have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) as applied to government units. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental accounting and financial reporting principles. The more significant of the School District's accounting policies are described below.

Reporting Entity

The School District is governed by an elected seven-member Board of Education (Board), which has responsibility and control over all activities related to public school education within the School District. The School District receives funding from local, state, and federal government sources and must comply with all of the requirements of these funding source entities. However, the School District is not included in any other governmental reporting entity as defined by generally accepted accounting principles. In addition, the School District's reporting entity does not contain any component units as defined in Governmental Accounting Standards Board Statement No. 14. Board members have decision-making authority, the power to designate management, the ability to significantly influence operations, and the primary accountability for fiscal matters.

District-wide and Fund Financial Statements

District-wide Financial Statements – The primary focus of district-wide financial statements is on the sustainability of the School District as an entity and the change in the School District's net assets resulting from the current year's activities. The district-wide financial statements (i.e., the Statement of Net Assets and the Statement of Activities) report information on all of the non-fiduciary activities of the School District. For the most part, the effect of interfund activity has been removed from these statements. The district-wide financial statements categorize primary activities as either governmental or business type. All of the School District's activities are classified as governmental activities.

In the district-wide Statement of Net Assets, the governmental activities column (a) is presented on a consolidated basis and (b) is reported on a full accrual, economic resource basis, which recognizes all long-term assets and receivables as well as long-term debt and obligations. The School District's net assets are reported in three parts – invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets.

The Statement of Activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. The School District first utilizes restricted resources to finance qualifying activities. *Direct expenses* are those that are clearly identifiable with a specific function or segment. *Program revenues* include 1) charges paid by recipients who purchase, use or directly benefit from goods or services by a given function or segment and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment. State Foundation Aid, certain revenue from the intermediate school district, and other unrestricted items are not included as program revenues but instead as *general revenues*.

The district-wide Statement of Activities reports both the gross and net cost of each of the School District's functions. The functions are also supported by general revenues (property taxes, certain intergovernmental revenues and charges, etc.). The Statement of Activities reduces gross expenses by related program revenues and operating grants. Program revenues must be directly associated with the function. Operating grants include operating-specific and discretionary (either operating or capital) grants. The School District does not allocate indirect costs.

Mason County Eastern School District
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

District-wide and Fund Financial Statements—Continued

Fund financial statements – Fund financial statements are provided for governmental funds and fiduciary funds, even though the latter are excluded from district-wide financial statements. Major individual governmental funds are reported as separate columns in the fund financial statements.

Governmental funds – Governmental funds are those funds through which most School District functions typically are financed. The acquisition, use and balances of the School District's expendable financial resources and the related current liabilities are accounted for through governmental funds.

The School District reports the following major governmental fund:

- The *General Fund* is the School District's primary operating fund. It accounts for all financial resources of the School District, except those required to be accounted for in another fund.

The other nonmajor governmental funds are reported within the following types:

- The *special revenue funds* account for revenue sources that are legally restricted to expenditures for specific purposes (not including expendable trusts or major capital projects). The School District accounts for its food service and athletic activities in the school service special revenue funds.
- The *debt service funds* account for the resources accumulated and payments made for principal and interest on long-term general obligation debt of governmental funds.

Fiduciary funds – Fiduciary funds account for assets held by the School District in a trustee capacity or as an agent on behalf of others. Trust funds account for assets held by the School District under the terms of a formal trust agreement. Fiduciary funds are not included in the district-wide statements.

- The *agency fund* is custodial in nature and does not present results of operations or have a measurement focus. Agency funds are accounted for using the modified accrual basis of accounting. This fund is used to account for assets that the School District holds for others in an agency capacity (primarily student activities).

Measurement Focus, Basis of Accounting and Basis of Presentation

Accrual Method

The district-wide financial statements are reported using the *economic resources measurement focus* and the *accrual basis of accounting* as are the fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Property taxes are recognized as revenues in the year for which they are levied. Grants, categorical aids and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

Modified Accrual Method

Governmental fund financial statements are reported using the *current financial resources measurement focus* and the *modified accrual basis of accounting*. With this measurement focus, operating statements present increases and decreases in net current assets, and unreserved fund balance is a measure of available spendable resources. Revenues are recognized as soon as they are both measurable and available. Revenues are considered to be *available* when they are collectible within the current period or soon enough thereafter to pay liabilities of the current period. For this purpose, the School District considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures generally are recorded when a liability is incurred, as under accrual accounting. However, debt service expenditures, as well as compensated absences and claims and judgments, are recorded only when payment is due.

Property taxes, unrestricted state aid, intergovernmental grants, and interest associated with the current fiscal period are all considered to be susceptible to accrual and so have been recognized as revenues of the current fiscal period. All other revenue items are considered to be measurable and available only when cash is received by the School District.

Mason County Eastern School District
NOTES TO FINANCIAL STATEMENTS—CONTINUED

June 30, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Measurement Focus, Basis of Accounting and Basis of Presentation—Continued

State Revenue

The State of Michigan utilizes a foundation grant approach which provides for a specific annual amount of revenue per pupil based on a statewide formula. The Foundation is funded from state and local sources. Revenues from state sources are primarily governed by the School Aid Act and the School Code of Michigan. The Michigan Department of Education administers the allocation of state funds to school districts based on information supplied by the school districts. For the year ended June 30, 2006, the foundation allowance was based on pupil membership counts taken in February and September of 2005.

The state portion of the foundation is provided primarily by a state education property tax millage of 6 mills and an allocated portion of state sales and other taxes. The local portion of the foundation is funded primarily by non-homestead property taxes which may be levied at a rate of up to 18 mills. The state revenue is recognized during the foundation period and is funded through payments from October 2005 to August 2006. Thus, the unpaid portion at June 30, 2006 is reported as due from other governmental units.

The School District also receives revenue from the state to administer certain categorical education programs. State rules require that revenue earmarked for these programs be used for its specific purpose. Certain governmental funds require an accounting to the state of the expenditures incurred. For categorical funds meeting this requirement, funds received, which are not expended by the close of the fiscal year, are recorded as deferred revenue. Other categorical funding is recognized when the appropriation is received.

Other Accounting Policies

Deposit and Investments

Cash and cash equivalents include cash on hand, demand deposits and short-term investments with a maturity of three months or less when acquired. Investments are stated at fair value.

The School District reports its investments in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Under this standard, certain investments are valued at fair value as determined by quoted market prices or by estimated fair values when quoted market prices are not available. The standard also provides that certain investments are valued at cost (or amortized cost) when they are of a short-term duration, the rate of return is fixed, and the School District intends to hold the investment until maturity.

State statutes authorize the School District to invest in bonds and other direct and certain indirect obligations of the U.S. Treasury; certificates of deposit, savings accounts, deposit accounts, or depository receipts of a bank, savings and loan association, or credit union, which is a member of the Federal Deposit Insurance Corporation, Federal Savings and Loan Insurance Corporation, or National Credit Union Administration, respectively; in commercial paper rated at the time of purchase within the three highest classifications established by not less than two standard rating services and which matures not more than 270 days after the date of purchase. The School District is also authorized to invest in U. S. Government or federal agency obligation repurchase agreements, bankers' acceptances of U.S. banks, and mutual funds composed of investments as outlined above. The School District's deposits and investments are in accordance with statutory authority.

Interfund Receivables and Payables

Activities between funds that are representative of lending or borrowing arrangements outstanding at the end of the fiscal year are referred to as either "due to/from other funds" (i.e., the current portion of interfund loans) or "advances to/from other funds" (i.e., the non-current portion of interfund loans). All other outstanding balances between funds are reported as "due to/from other funds". The School District had no advances between funds.

Mason County Eastern School District
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Other Accounting Policies—Continued

Property Taxes

Property taxes levied by the School District are collected by various municipalities and periodically remitted to the School District. The taxes are levied as of December 1 and are due upon receipt of the billing by the taxpayer and become a lien on the first day of the levy year. The actual due date is February 14, after which time the bills become delinquent and penalties and interest may be assessed by the collecting entity.

For the year ended June 30, 2006, the School District levied the following amounts per \$1,000 of taxable valuation:

<u>Fund</u>	<u>Mills</u>
General Fund—Non-homestead	18
Debt service fund—Homestead and non-homestead	3.6

Inventories

Food service inventories are valued at the lower of cost (first-in, first-out) or market. Inventories are expendable supplies held for consumption and are recorded as expenditures when consumed rather than when purchased. Inventories for commodities are recorded as revenue when utilized.

Prepaid Items

Payments made to vendors for services that will benefit periods beyond the fiscal year end are recorded as prepaid items using the consumption method. A current asset for the prepaid amount is recorded at the time of the purchase and an expenditure/expense is reported in the year in which services are consumed.

Restricted Assets

Assets are reported as restricted when limitations on their use change the normal understanding of the availability of the asset. Such constraints are either imposed by creditors, contributors, grantors, or laws of other governments or imposed by enabling legislation. Restricted assets include bond proceeds to be used for capital construction.

Capital Assets

Capital assets purchased or acquired are capitalized at historical cost or estimated historical cost. Donated fixed assets are valued at their estimated fair market value on the date received. Capital assets are defined by the School District as assets with an initial cost of more than \$5,000 and an estimated useful life in excess of one year. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. Improvements are capitalized and depreciated over the remaining useful lives of the related fixed assets. The School District does not have infrastructure-type assets.

Depreciation is provided on the straight-line basis over the following useful lives:

Building and improvements	10-50 years
Buses and other vehicles	10-15 years
Furniture and other equipment	5-15 years

Land and certain land improvements are deemed to be inexhaustible capital assets, as the economic benefit or service potential is used up so slowly that the estimated useful life is extraordinarily long. These inexhaustible assets are not depreciated.

Mason County Eastern School District
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Other Accounting Policies—Continued

Compensated Absences

The liability for compensated absences reported in the district-wide statement consists of unpaid, accumulated sick leave and vacation balances. The liability has been calculated using the vesting method, in which leave amounts for both employees who are currently eligible to receive termination payments and other employees who are expected to become eligible in the future to receive such payments upon termination are included.

For fund financial statements, no compensated absence liability is reported for current employees and a compensated absence liability is reported for terminated employees only when the termination date is on or before year end.

Deferred Revenue

Deferred revenue arises when assets are recorded before revenue recognition criteria have been satisfied. Grants and entitlements received before the eligibility requirements are met are also recorded as deferred revenue. On fund financial statements, receivables that will be collected after the available period are reported as deferred revenue.

Long-term Obligations

In the district-wide financial statements, long-term debt and other long-term obligations are reported as liabilities in the Statement of Net Assets. Bond premiums and discounts, as well as issuance cost, are deferred and amortized over the life of the bonds using the effective interest method. Bonds payable are reported net of the applicable bond premium or discount. Bond issuance costs, if any, are reported as deferred charges and amortized over the term of the related debt.

In the fund financial statements, governmental fund types recognize bond premiums and discounts, as well as bond issuance costs, during the current period. The face amount of debt issued is reported as other financing sources. Premiums received on debt issuances are reported as other financing sources while discounts on debt issuances are reported as other financing uses. Issuance costs, whether or not withheld from the actual debt proceeds received, are reported as debt service.

Net Assets In District-wide Financial Statements

Net assets represent the difference between assets and liabilities and are segregated into the following components:

- **Invested in capital assets, net of related debt** consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes, and other debt that are attributed to the acquisition, construction, or improvement of those assets.
- **Restricted net assets** result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributions, and the like, or imposed by law through constitutional provisions or enabling legislation.
- **Unrestricted net assets** consist of net assets which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, to indicate that management does not consider them to be available for general operations. Unrestricted net assets often have constraints on resources which are imposed by management, but can be removed or modified.

Mason County Eastern School District
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE A—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES—Continued

Other Accounting Policies—Continued

Fund Equity In Fund Financial Statements

The School District reserves those portions of governmental fund balances that are legally segregated for specific future use or which do not represent available expendable resources and therefore are not available for appropriations for expenditures. Unreserved fund balance indicates that portion of fund equity which is available for appropriation in future periods. Fund balance reserves are established for encumbrances, inventory of materials and supplies, prepaid items, deferred charges and advances to other funds, when applicable. Designations of fund balance represent tentative management plans that are subject to change.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statement and accompanying notes. Actual results may differ from those estimates.

NOTE B—STEWARDSHIP, COMPLIANCE AND ACCOUNTABILITY

Budgets and Budgetary Accounting

Budgets are adopted on a basis consistent with accounting principles generally accepted in the United States of America. Annual appropriated budgets are adopted for the General Fund and special revenue funds. All annual appropriations lapse at year end.

The School District follows these procedures in establishing the budgetary data reflected in the financial statements:

1. The Superintendent submits to the School Board a proposed operating budget for the fiscal year commencing on July 1. The operating budget includes proposed expenditures and the means of financing them. The level of control for the budgets is at the functional level as set forth and presented as required supplementary information.
2. Public hearings are conducted to obtain taxpayer comments.
3. Prior to July 1, the budget is legally adopted by Board of Education resolution pursuant to the Uniform Budgeting and Accounting Act (P.A. 621 of 1978). The Act requires that the budget be amended prior to the end of the fiscal year when necessary to adjust appropriations if it appears that revenues and other financing sources will be less than anticipated or so that expenditures will not be in excess of original estimates. Expenditures shall not be made or incurred, unless authorized in the budget, in excess of the amount appropriated. Violations, if any, are noted in the required supplementary information section.
4. The Business Manager is authorized to transfer budgeted amounts within major expenditure functions within any fund; however, these transfers and any revisions that alter the total expenditures of any fund must be approved by the Board of Education.
5. Formal budgetary integration is employed as a management control device during the year.
6. The budget is amended during the year with supplemental appropriations, the last one approved prior to June 30, 2006. The School District does not consider these amendments to be significant.

Excess of Expenditures Over Appropriations

For the year ended June 30, 2006, expenditures exceeded appropriations in pupil services and business services by \$7,010 and \$13,220, respectively.

Mason County Eastern School District
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE C—DEPOSITS AND INVESTMENTS

As of June 30, 2006, the School District had the following investments:

Investment Type	Fair value	Weighted average maturity (Days)	Standard & Poor's Rating	Percent
External investment pool	\$ 189,167	1	AAAm	18.4%
Guaranteed Investment Contract (GIC)	<u>837,591</u>	<u>21</u>	A1+	<u>81.6</u>
Total fair value	\$ <u>1,026,758</u>			<u>100.0%</u>
Portfolio weighted average maturity		<u>15</u>		

The School District voluntarily invests certain excess funds in external pooled investment funds which included money market funds. One of the pooled investment funds utilized by the School District is the Michigan Investment Liquid Asset Fund (MILAF). MILAF is an external pooled investment fund of "qualified" investments for Michigan school districts. MILAF is not regulated nor is it registered with the SEC. MILAF reports as of June 30, 2006, the fair value of the School District's investments is the same as the value of the pool shares.

Interest rate risk. The School District does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit risk. State law limits investments in commercial paper and corporate bonds to the three highest classifications issued by nationally recognized statistical rating organizations. The School District has no investment policy that would further limit its investment choices.

Concentration of credit risk. The School District does not have a concentration of credit risk policy. Concentration of credit risk is the risk of loss attributed to the magnitude of the School District investment in a single issuer, by diversifying the investment portfolio so that the impact of potential losses from any one type of security or issuer will be minimized.

Custodial credit risk - deposits. In the case of deposits, this is the risk that in the event of a bank failure, the School District's deposits may not be returned to it. As of June 30, 2006, \$433,372 of the School District's bank balance of \$633,372 was exposed to custodial credit risk because it was uninsured and uncollateralized.

Custodial credit risk - investments. The School District does not have a custodial credit risk policy for investments. This is the risk that, in the event of the failure of the counterparty, the School District will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party.

Mason County Eastern School District
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE C—DEPOSITS AND INVESTMENTS—Continued

Custodial credit risk - investments—Continued

The School District's Guaranteed Investment Contract is collateralized and invested for the purpose of paying off the state aid anticipation note disclosed in Note F. The Investment Agreement, dated as of August 20, 2005, by and among J.P. Morgan Trust Company, National Association, as the Depository on behalf of both the participating Michigan School Districts and the Michigan Municipal Bond Authority, and Citigroup Global Markets, Inc., as Provider. The net proceeds from the sale of the Series B-1 Notes were loaned by the Authority to Michigan School Districts. Such loans were repaid with monthly set-a-side installments deposited with the Depository for investment under the Investment Agreement. Set-a-side installments are deposited under the Investment Agreement versus Permitted Investments (collateral securities) equaling at least 103 percent of the deposited amount and such Permitted Investments are held by the Depository in a fiduciary capacity. The Guaranteed Rate under this Investment Agreement (commonly referred to as guaranteed investment contract-GIC or collateralized investment agreement-CIA) is 4.09 percent (simple interest actual days elapsed over a 365-day year). The Guarantor is Citigroup Global Markets Holdings, Inc., as guarantor of the Provider's obligations under this Investment Agreement.

Foreign currency risk. The School District is not authorized to invest in investments which have this type of risk.

NOTE D—CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2006 was as follows:

	<u>Balance</u> <u>July 1, 2005</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance</u> <u>June 30, 2006</u>
Capital assets, not being depreciated:				
Land	\$ 86,079	\$ -	\$ -	\$ 86,079
Capital assets, being depreciated:				
Land improvements	229,948	-	-	229,948
Buildings and improvements	5,647,927	200	-	5,648,127
Office furniture and equipment	238,077	23,164	-	261,241
Vehicles and equipment	468,056	56,900	-	524,956
Total capital assets, being depreciated	6,584,008	80,264	-	6,664,272

Mason County Eastern School District
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE D—CAPITAL ASSETS—Continued

	Balance <u>July 1, 2005</u>	<u>Additions</u>	<u>Deductions</u>	Balance <u>June 30, 2006</u>
Less accumulated depreciation:				
Land improvements	\$ 74,995	\$ 9,775	\$ -	\$ 84,770
Buildings and improvements	1,218,396	122,969	-	1,341,365
Office furniture and equipment	73,240	19,754	-	92,994
Vehicles and equipment	<u>321,227</u>	<u>31,457</u>	<u>-</u>	<u>352,684</u>
Total accumulated depreciation	<u>1,687,858</u>	<u>183,955</u>	<u>-</u>	<u>1,871,813</u>
Total capital assets, being depreciated, net	<u>4,896,150</u>	<u>(103,691)</u>	<u>-</u>	<u>4,792,459</u>
Capital assets, net	<u>\$ 4,982,229</u>	<u>\$ (103,691)</u>	<u>\$ -</u>	<u>\$ 4,878,538</u>

Depreciation

Depreciation expense has been charged as unallocated depreciation.

NOTE E—INTERFUND RECEIVABLES, PAYABLES AND TRANSFERS

The composition of interfund balances as of June 30, 2006 is as follows:

Due to/from other funds:

<u>Receivable fund</u>	<u>Payable Fund</u>	<u>Amount</u>
General Fund	Other governmental funds	\$ <u>1,572</u>

The outstanding balances between funds result mainly from the time lag between the dates that (1) interfund goods and services are provided or reimbursable expenditures occur, (2) transactions are recorded in the accounting system, and (3) payments between funds are made.

Interfund Transfers

The General Fund transferred \$99,849 to the Athletics Fund to finance operations.

Mason County Eastern School District
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE F—SHORT-TERM DEBT

The School District issues State of Michigan school aid anticipation notes to provide short-term operating funds. The notes are obligations of the General Fund, which received the note proceeds, and are backed by the full faith, credit and resources of the School District. The short-term debt activity for the year ended June 30, 2006 follows:

	Balance July 1, 2005		Additions		Reductions		Balance June 30, 2006
State aid anticipation note							
2004/2005 1.55% due August 2005	\$ 1,000,000	\$	-	\$	1,000,000	\$	-
2005/2006 2.87% due August 2006	<u>-</u>		<u>950,000</u>		<u>-</u>		<u>950,000</u>
	<u>\$ 1,000,000</u>	\$	<u>950,000</u>	\$	<u>1,000,000</u>	\$	<u>950,000</u>

NOTE G—LONG-TERM OBLIGATIONS

The School District issues bonds, notes and other contractual commitments to provide for the acquisition, construction and improvement of major capital facilities and for the acquisition of certain equipment. General obligation bonds are direct obligations and pledge the full faith and credit of the School District. Other long-term obligations include capital leases for office equipment and school bus loans.

Summary of Long-term Obligations

The following is a summary of long-term obligations activity for the School District for the year ended June 30, 2006.

	Balance July 1, 2005		Additions		Reductions		Balance June 30, 2006		Due within one year
Governmental activities:									
Bonds	\$ 4,496,943	\$	-	\$	192,420	\$	4,304,523	\$	212,535
Other obligations	40,207		69,700		7,842		102,065		21,902
Compensated absences	<u>65,708</u>		<u>23,384</u>		<u>25,004</u>		<u>64,088</u>		<u>-</u>
	<u>\$ 4,602,858</u>	\$	<u>93,084</u>	\$	<u>225,266</u>	\$	<u>4,470,676</u>	\$	<u>234,437</u>

In the previous schedule, the additions for other obligations of \$69,700 includes a \$12,800 capital lease and \$56,900 for a school bus loan.

Mason County Eastern School District
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE G—LONG-TERM OBLIGATIONS—Continued

Summary of Long-term Obligations—Continued

General obligation bonds consist of the following:

1999 School Building and Site and Refunding General Obligation Bond payable in annual installments ranging from \$200,000 to \$435,000 due May 2007 to 2019; plus interest ranging from 4.35% to 4.95% payable semi-annually	\$ 4,200,000
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2002 School Building and Site General Obligation Bond payable in annual installments ranging from \$10,000 to \$15,000 due May 2007 to 2012; plus interest ranging from 4.8% to 4.85% payable semi-annually	75,000
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Durant obligations payable in annual installments ranging from \$3,511 to \$16,569 including interest at 4.76% due May 15, 2007 to 2013; The School District is only obligated to make the annual payments to the extent of annual State of Michigan state school aid appropriations	<u>29,523</u>
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Total bonded debt	4,304,523
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Other obligations

School bus installment loan payable in annual installments of \$11,380, plus interest at 3.34%; final payment due August 2010	56,900
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Capital lease obligations, secured by equipment, payable in monthly installments of \$1,323, including interest ranging from 11.67% to 12.5%; final payment due July 2011	<u>45,165</u>
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Total other obligations	102,065
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Compensated absences	<u>64,088</u>
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\$ 4,470,676

The Durant bonds, including interest, were issued in anticipation of payment to the School District as appropriated and to be appropriated by the State of Michigan under Section 11g(3) of Act 94 (State Aid payments). The School District has pledged and assigned to the bondholder all rights to these State Aid payments as security for the Bond. The note receivable on the Statement of Net Assets is for the future appropriations from the State of Michigan to pay the Durant obligations.

Mason County Eastern School District
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE G—LONG-TERM OBLIGATIONS—Continued

Summary of Long-term Obligations—Continued

The annual requirements of principal and interest to amortize bonded debt, capital leases and school bus loans outstanding as of June 30, 2006 follows:

<u>June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 234,437	\$ 209,680	\$ 444,117
2008	256,357	198,735	455,092
2009	278,095	186,568	464,663
2010	299,191	173,568	472,759
2011	322,643	160,014	482,657
2012-2016	1,760,865	571,738	2,332,603
2017-2020	1,255,000	125,978	1,380,978
	<u>\$ 4,406,588</u>	<u>\$ 1,626,281</u>	<u>\$ 6,032,869</u>

NOTE H—EMPLOYEE BENEFITS

Employee Retirement System – Defined Benefit Plan

Plan description – The School District contributes to the statewide Michigan Public School Employees' Retirement System (MPERS), a cost sharing multiple-employer defined benefit pension plan administered by the nine member board of the MPERS. The MPERS provides retirement benefits and post-retirement benefits for health, dental and vision. The MPERS was established by Public Act 136 of 1945 and operated under the provisions of Public Act 300 of 1980, as amended. The MPERS issues a publicly available financial report that includes financial statements and required supplementary information for MPERS. That report may be obtained by writing to or calling:

Office of Retirement Systems
Michigan Public School Employees Retirement System
P.O. Box 30171
Lansing Michigan 48909
1-800-381-5111

Funding policy – Member Investment Plan (MIP) members enrolled in MIP prior to January 1, 1990 contribute a permanently fixed rate of 3.9 percent of gross wages. The MIP contribution rate was 4.0 percent from January 1, 1987, the effective date of the MIP, until January 1, 1990 when it was reduced to 3.9 percent. Members first hired January 1, 1990 or later and returning members who did not work between January 1, 1987 and December 31, 1989 contribute at the following graduated permanently fixed contribution rate: 3 percent of the first \$5,000; 3.6 percent of \$5,001 through \$15,000; 4.3 percent of all wages over \$15,000.

Basic Plan members make no contributions. For a limited period ending December 31, 1992, an active Basic Plan member could enroll in the MIP by paying the contributions that would have been made had enrollment occurred initially on January 1, 1987 or on the date of hire, plus interest. MIP contributions at the rate of 3.9 percent of gross wages begin at enrollment. Market rate interest is posted to member accounts on July 1st on all MIP monies on deposit for 12 months. If a member leaves MPERS service and no pension is payable, the member's accumulated contribution plus interest, if any, are refundable.

Mason County Eastern School District
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE H—EMPLOYEE BENEFITS—Continued

Employee Retirement System – Defined Benefit Plan—Continued

Funding policy—Continued

The School District is required to contribute the full actuarial funding contribution amount to fund pension benefits, plus an additional amount to fund retiree health care benefit amounts on a cash disbursement basis. The rate for the year ended June 30, 2006 was 16.34 percent of payroll. The contribution requirements of plan members and the School District are established and may be amended by the MPSERS Board of Trustees. The School District contributions to MPSERS for the year ended June 30, 2006, 2005 and 2004 were approximately \$449,000, \$398,000 and \$362,000, respectively, and were equal to the required contribution for those years.

The School District is not responsible for the payment of retirement benefits which is the responsibility of the State of Michigan.

Other post-employment benefits – Under the MPSERS Act, all retirees have the option of continuing health, dental and vision coverage.

NOTE I—COMMITMENTS AND CONTINGENCIES

Commitments

- The School District leases a school building and adjacent playground facilities from St. Mary's Church of Custer. The lease, which expires June 2009, provides for annual rents of approximately \$7,000 through June 2006 with annual adjustments thereafter based upon changes in the Consumer Price index. The School District has the option to renew for three additional terms of five years each at a mutually-agreeable rate.
- The School District leases the Fountain School building to FiveCAP, Inc. a non-profit corporation. The School District has negotiated a twenty-year lease expiring August 2018. Under terms of the lease, the building will be leased for one dollar per year with FiveCAP, Inc. responsible for maintenance, repairs, and operational costs of the building.

Contingencies

- The School District participates in federally-assisted grant programs, which are subject to program compliance audits by the grantor or its representatives. Such audits of these programs may be performed at some future date. The amount, if any, of expenditures which may be disallowed by the granting agencies cannot be determined at this time although the School District expects such amounts, if any, to be immaterial.

Mason County Eastern School District
NOTES TO FINANCIAL STATEMENTS—CONTINUED
June 30, 2006

NOTE J—OTHER INFORMATION

Economic dependence - Prior years revision of the State of Michigan (State) school aid formula for local public schools significantly increased State school aid, and the change in property tax laws significantly decreased local property tax revenues. As a result, State school aid represents approximately 72.8 percent of General Fund revenues.

Risk management – The School District is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; error and omissions; injuries to employees; and natural disasters. The School District participates in two distinct pools of educational institutions within the State of Michigan for self-insuring property and casualty and workers' disability compensation. The pools are considered public entity risk pools. The School District pays annual premiums under a retrospectively rated policy to the pools for the respective insurance coverage. In the event a pool's total claims and expenses for a policy year exceed the total normal annual premiums for said years, all members of the specific pool's policy year may be subject to special assessment to make up the deficiency. The workers' compensation pool and the property casualty pool maintain reinsurance for claims generally in excess of \$500,000 for each occurrence with the overall maximum coverage varying depending on the specific type coverage of reinsurance.

The School District continues to carry commercial insurance for other risks of loss, including employee health and accident insurance. No settlements have occurred in excess of coverage for June 30, 2006 or any of the prior three years.

NOTE K—SUBSEQUENT EVENT

In August 2006, the School District received the proceeds of a \$1,000,000 State of Michigan (State) school aid anticipation note payable. The note payable is not subject to redemption prior to its maturity in August 2007 and bears interest at the rate of 3.68 percent per annum. The School District pledged for payment of the note payable, the amount of state school aid to be received plus the full faith, credit, and resources of the School District.

REQUIRED SUPPLEMENTARY INFORMATION

Mason County Eastern School District
REQUIRED SUPPLEMENTARY INFORMATION
BUDGETARY COMPARISON SCHEDULE
General Fund
For the year ended June 30, 2006

	Budgeted amounts			Variance with final budget - positive (negative)
	Original	Final	Actual	
REVENUES				
Local sources	\$ 847,592	\$ 964,635	\$ 979,886	\$ 15,251
State sources	3,794,568	3,572,825	3,576,345	3,520
Federal sources	259,828	264,348	269,779	5,431
Incoming transfers and other transactions	58,000	63,300	88,118	24,818
Total revenues	4,959,988	4,865,108	4,914,128	49,020
EXPENDITURES				
Instruction				
Basic programs	2,611,589	2,549,582	2,496,969	52,613
Added needs	651,799	546,047	536,709	9,338
Support services				
Pupil	154,237	187,626	194,636	(7,010)
General administration	278,992	245,262	242,024	3,238
School administration	338,014	342,385	336,132	6,253
Business	111,347	105,444	118,664	(13,220)
Operations and maintenance	549,933	441,035	430,140	10,895
Pupil transportation services	389,708	387,138	376,309	10,829
Central	-	119,262	120,373	(1,111)
Outgoing transfers and other transactions	120,400	119,800	112,269	7,531
Total expenditures	5,206,019	5,043,581	4,964,225	79,356
Excess (deficiency) of revenues over (under) expenditures	\$ <u>(246,031)</u>	\$ <u>(178,473)</u>	(50,097)	\$ <u>128,376</u>
Fund balances at July 1, 2005			726,028	
Fund balances at June 30, 2006			\$ <u>675,931</u>	

OTHER DOCUMENTS

BRICKLEY DELONG

CERTIFIED PUBLIC ACCOUNTANTS

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

August 30, 2006

Board of Education
Mason County Eastern School District
Custer, Michigan

We have audited the accompanying financial statements of the governmental activities, each major fund and the aggregate remaining fund information of Mason County Eastern School District, as of and for the year ended June 30, 2006, which collectively comprise the Mason County Eastern School District's basic financial statements and have issued our report thereon dated August 30, 2006. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered Mason County Eastern School District's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect Mason County Eastern School District's ability to initiate, record, process and report financial data consistent with the assertions of management in the financial statements. The reportable condition has been reported to the management of Mason County Eastern School District in a separate letter dated August 30, 2006.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we do not believe that the reportable condition describe above is a material weakness.

BRICKLEY DELONG

Board of Education

August 30, 2006

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether Mason County Eastern School District's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the audit committee, management, Board of Education, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

Brickley DeLong, PLC

BRICKLEY DELONG

CERTIFIED PUBLIC ACCOUNTANTS

August 30, 2006

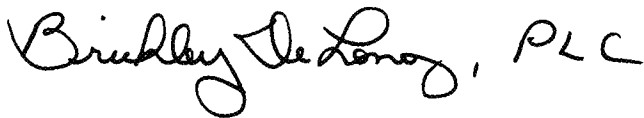
Board of Education
Mason County Eastern School District
Custer, Michigan

In planning and performing our audit of the financial statements of Mason County Eastern School District for the year ended June 30, 2006, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control. However, we noted a matter involving internal control and its operation that we consider to be a reportable condition under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control that, in our judgment, could adversely affect Mason County Eastern School District's ability to initiate, record, process and report financial data consistent with the assertions of management in the financial statements. We have attached a summary of such reportable condition.

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of internal control would not necessarily disclose all matters in internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses as defined above. However, the reportable condition described above is not believed to be a material weakness.

This report is intended solely for the information of the Board of Education, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Brickley DeLong, PLC". The signature is written in a cursive, flowing style.

REPORTABLE CONDITIONS

Recommendation 1: Internal control procedures should be further strengthened.

Small school districts with limited resources and personnel inherently have difficulty in establishing and maintaining an accounting system with strong internal accounting controls including significant segregation of duties.

The School District's existing accounting system has functions with internal accounting control weaknesses which could allow material errors or misappropriations to go undetected. Appropriate enhancement of the internal accounting controls would provide reasonable, but not absolute, assurance as to the safeguarding of assets against the loss from unauthorized use or disposition, and the reliability of financial records.

The School District should continue using its current accounting systems, but it should seek opportunities to further strengthen internal accounting controls. Often, the most effective approach is the expansion of documented review and approval of transactions by the Superintendent, other appropriate administrators, and/or the Board of Education and committees thereof.